Community Health Center of Branch County
A Component Unit of Branch County, Michigan

Accountants' Report and Financial Statements

December 31, 2006 and 2005

Michigan Department of Treasury
496 (02/06)

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type	Local Unit Name	County
☐County ☐City ☐Twp ☐Village ☒Other	Community Health Center of Branch County	Branch

Fiscal Year End	Opinion Date	Date Audit Report Submitted to State
12/31/06	3/27/07	May 7, 2007

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

	YES	NO	**Check each applicable box below.** (See instructions for further detail.)
1.	☒	☐	All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2.	☒	☐	There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3.	☒	☐	The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4.	☒	☐	The local unit has adopted a budget for all required funds.
5.	☒	☐	A public hearing on the budget was held in accordance with State statute.
6.	☒	☐	The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7.	☒	☐	The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8.	☒	☐	The local unit only holds deposits/investments that comply with statutory requirements.
9.	☒	☐	The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10.	☒	☐	There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11.	☒	☐	The local unit is free of repeated comments from previous years.
12.	☒	☐	The audit opinion is UNQUALIFIED.
13.	☒	☐	The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14.	☒	☐	The board or council approves all invoices prior to payment as required by charter or statute.
15.	☒	☐	To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)
Financial Statements	☒	
The letter of Comments and Recommendations	☒	
Other (Describe)	☐	

Certified Public Accountant (Firm Name)	Telephone Number		
BKD LLP	260-460-4000		
Street Address	**City**	**State**	**Zip**
200 E Main Street, Suite 700	Ft Wayne	IN	46802
Authorizing CPA Signature	**Printed Name**	**License Number**	
Thomas P. Cottrell CPA	Tom Cottrell	CP09100234	

Community Health Center of Branch County
A Component Unit of Branch County, Michigan
December 31, 2006 and 2005

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Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Trustees
Community Health Center of Branch County
Coldwater, Michigan

We have audited the accompanying balance sheets of Community Health Center of Branch County, a component unit of Branch County, Michigan, as of December 31, 2006 and 2005, and the related statements of revenue, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Community Health Center of Branch County, a component unit of Branch County, Michigan as of December 31, 2006 and 2005, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the Hospital's basic financial statements. The accompanying supplementary information as listed in the table of contents is presented for purposes of additional analysis of the financial statements rather than to present the financial position and changes in financial position of the individual organizations, and is not a required part of the basic financial statements. The supplementary information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

BKD, LLP

March 27, 2007

Community Health Center of Branch County
A Component Unit of Branch County, Michigan
Management's Discussion and Analysis
Years Ended December 31, 2006 and 2005

Introduction

This discussion and analysis of Community Health Center of Branch County's (Hospital) financial statements provides an overview of the Hospital's financial activities for the years ended December 31, 2006 and 2005. It should be read in conjunction with the accompanying financial statements. Management is responsible for the completeness and fairness of the financial statements and the related footnote disclosures along with the discussion and analysis.

Financial Highlights

The Hospital's financial position including the Hospital and Community Health Center Foundation, Inc. (Foundation) improved during the year ended December 31, 2006. Current assets decreased by approximately $374,000 or 1.5% from the prior year. A substantial portion of this decrease is due to the use of cash to complete the construction of the new MRI center. Total assets increased by approximately $921,000 or 2.0% from the prior year due to primarily to an increase in noncurrent cash and investments.

In total, the Hospital's net assets increased approximately $1,147,000 or 3.3% from the previous year. Over 52%, or approximately $597,000, of this increase was attributable to hospital operations.

In the year ended December 31, 2006, the Hospital's revenue and nonoperating income exceeded expenses, creating an increase in net assets of $1,147,364, compared to a $1,212,894 increase in the previous year. Revenue increased $2,367,946 or 4.2% from the previous year. The primary cause of this increase is due to a 2% increase in activity over the prior year as represented in adjusted patient days. The most significant increase in expenses was associated with supplies, which increased to 22% of total expenses in 2006 from 21% in 2005. The primary cause of this increase was attributable to the continued increase in medical drugs and supplies.

For the year ending December 31, 2005, current assets increased by approximately $5,203,000 or 28% from the prior year. A substantial portion of this increase was due to current assets generated from 2005 operations as well as proceeds from the issuance of long-term debt. In total, the Hospital's net assets increased approximately $1,213,000 or 4% in 2005 from 2004. Over 64%, or approximately $779,000, of this increase was attributable to hospital operations.

In the year ended December 31, 2005, the Hospital's revenue and nonoperating income exceeded expenses, creating an increase in net assets of $1,212,894, compared to a $1,563,484 increase in the previous year. The most significant increase in expenses was associated with fringe benefits which increased to 28.3% of salaries in fiscal year 2005 from 25.4% of salaries in 2004. The primary cause of this increase was attributable to employee health insurance.

Using This Annual Report

This annual financial report includes the report of independent auditors, this management discussion and analysis, the financial statements in the above referred format and notes to financial statements.

These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Hospital is accounted for as a business-type activity and presents its financial statements using the "economic resources measurement focus" and the accrual basis of accounting. The "economic resources

measurement focus" refers to our acceptance of FASB (Financial Accounting Standards Board) rules unless in conflict with GASB (Governmental Accounting Standards Board) rules.

The Balance Sheet and Statement of Revenue, Expenses and Changes in Net Assets

One of the most important questions asked about any hospital's finances is "Is the Community Health Center of Branch County as a whole better or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Revenue, Expenses and Changes in Net Assets report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. Using the accrual basis of accounting means that all of the current year's revenue and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net assets and changes in them. The Hospital's total net assets—the difference between assets and liabilities—is one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net assets are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Hospital.

The Statement of Cash Flows

The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what was cash used for and what was the change in cash and cash equivalents during the reporting period.

The Hospital's Combined Net Assets

The Hospital's net assets are the difference between its assets and liabilities reported in the Balance Sheet. The Hospital's net assets increased by $1,147,364 (3.3%) in 2006 over 2005, and by $1,212,894 (4%) in 2005 over 2004, as shown in Table 1.

Table 1: Assets, Liabilities and Net Assets

	2006	2005	2004
Assets			
Patient accounts receivable, net	$ 5,990,792	$ 6,474,353	$ 6,715,778
Other current assets	17,123,545	17,013,558	11,568,900
Capital assets, net	19,969,051	19,808,951	21,062,389
Other noncurrent assets	3,548,129	2,414,034	2,715,251
Total assets	$ 46,631,517	$ 45,710,896	$ 42,062,318
Liabilities			
Long-term debt	$ 4,754,332	$ 5,137,526	$ 3,490,000
Other current and noncurrent liabilities	5,403,962	5,247,511	4,459,353
Total liabilities	10,158,294	10,385,037	7,949,353

	2006	2005	2004
Net Assets			
Invested in capital assets, net of related debt	$ 15,214,719	$ 14,671,425	$ 18,039,404
Restricted expendable	1,533,687	1,697,910	1,046,250
Unrestricted	19,724,817	18,956,524	15,027,311
Total net assets	36,473,223	35,325,859	34,112,965
Total liabilities and net assets	$ 46,631,517	$ 45,710,896	$ 42,062,318

A significant change in the Hospital's assets in 2006 is the decrease in patient accounts receivable. Although net patient service revenue increased in 2006 by $2,367,946 (4.2%) as compared to 2005, net patient accounts receivable decreased by $483,561 (7.4%) or 3.0 days of revenue at December 31, 2006 versus December 31, 2005. The decrease results primarily from improved business office operations.

A significant change in the Hospital's assets in 2005 is the decrease in patient accounts receivable. Although net patient service revenue increased in 2005 by $8,029,631 (16%) as compared to 2004, net patient accounts receivable decreased by $241,425 (4%) or 1.5 days of revenue at December 31, 2005 versus December 31, 2004. The decrease results primarily from improved business office operations.

Operating Results and Changes in the Hospital's Net Assets

In 2006, the Hospital's net assets increased by $1,147,364 or 3%, as shown in Table 2. This increase is primarily due to higher investment income due to improved interest rates and represents an increase of 3% compared with the increase in net assets for 2005 of $1,212,894. The Hospital's change in net assets decreased from $1,563,484 in 2004 to $1,212,894 in 2005, a decrease of 22%.

Table 2: Operating Results and Changes in Net Assets

	2006	2005	2004
Operating Revenue			
Net patient service revenue	$ 58,370,311	$ 56,002,365	$ 50,845,101
Other operating revenue	391,875	391,132	616,828
Total operating revenue	58,762,186	56,393,497	51,461,929
Operating Expenses			
Salaries and wages and employee benefits	31,288,501	30,105,206	26,719,269
Purchased services and professional fees	7,931,309	7,703,054	7,468,995
Depreciation and amortization	2,549,895	2,788,577	2,859,008
Other operating expenses	16,395,374	15,017,965	13,814,181
Total operating expenses	58,165,079	55,614,802	50,861,453
Operating Income	597,107	778,695	600,476
Nonoperating Revenue (Expenses)			
Investment income	678,532	298,783	136,438
Contributions, net of program expenses	140,269	167,098	797,697
Donations, net of program expenses	(64,853)	(24,363)	—
Interest expense	(196,750)	(151,415)	(163,953)
Other nonoperating revenue and expenses, net	(6,941)	144,096	192,826
Total nonoperating revenue	550,257	434,199	963,008
Increase in Net Assets	$ 1,147,364	$ 1,212,894	$ 1,563,484

Operating Revenue

Operating revenue includes all transactions that result in the sales and/or receipts from goods and services, such as inpatient services, outpatient services, physician offices and the cafeteria.

Operating revenue changes were a result of the following factors:

- For 2006, net patient service revenue increased 4% from prior year due primarily to an increase in activity as shown by 2.7% increase in adjusted patient days from 45,201 days in 2005 to 46,463 days in 2006. Gross patient revenue is reduced by revenue deductions and provision for bad debt expense. Revenue deductions are the amounts that are not paid to the Hospital under contractual arrangements primarily with Medicare, Medicaid and Blue Cross Blue Shield. These revenue deductions increased from 50.8% to 53.5% as a percentage of gross revenue in 2006 as compared to 2005.

- For 2005, net patient service revenue increased 10% from prior year. Revenue deductions increased from 48.4% to 50.8% as a percentage of gross revenue in 2005 as compared to 2004.

Operating Expenses

Operating expenses are all the costs necessary to perform and conduct the services and primary purposes of the Hospital. Significant operating expense changes were the result of the following factors:

- For 2006, salaries, which account for approximately 43% of total operating expenses increased approximately 7%, which was primarily related to raises and staffing fluctuations associated with different volumes of occupancy and utilization.

- Also for 2006, the most significant increase in operating expenses and revenue deductions was associated with supply expenses, specifically drug costs. Drug costs increased approximately 11% over 2005.

- For 2005, salaries, which account for approximately 41% of total operating expenses increased approximately 9%, which was primarily related to raises and staffing fluctuations associated with different volumes of occupancy and utilization.

- Also for 2005, the most significant increase in operating expenses and revenue deductions was associated with fringe benefits, specifically employee health insurance. Employee health cost increased nearly 52% over fiscal year 2004 and 18% over the 2005 budget.

Nonoperating Revenue and Expenses

Nonoperating revenue and expenses are all sources and uses that are primarily nonexchange in nature. They would consist primarily of donations, interest expense and investment income (including realized and unrealized gains and losses).

The Foundation received approximately $139,000 and $157,000 of donations in 2006 and 2005, respectively.

Statement of Cash Flows

Another way to assess the financial health of a hospital is to review the Statement of Cash Flows. Its primary purpose is to provide relevant information about the cash receipts and cash payments of an entity during a period. The Statement of Cash Flows also helps assess:

- An entity's ability to generate future net cash flows

- Its ability to meet its obligations as they come due
- Its needs for external financing

Changes in the Hospital's cash flows are consistent with changes in operating income and nonoperating revenue and expenses for 2006, 2005 and 2004 as discussed earlier.

Statement of Cash Flows

	2006	2005	2004
Cash Provided by (Used in)			
Operating activities	$ 2,198,864	$ 3,808,319	$ 3,377,549
Noncapital financing activities	107,855	223,582	1,051,067
Capital and related financial activities	(3,298,681)	(42,709)	(2,092,587)
Investing activities	354,007	(6,773,963)	(29,884)
Net increase (decrease) in cash	(637,955)	(2,784,771)	2,306,145
Cash, Beginning of Year	6,357,251	9,142,022	6,835,877
Cash, End of Year	$ 5,719,296	$ 6,357,251	$ 9,142,022

The Hospital's liquidity decreased during the year ended December 31, 2006, due primarily to the continued construction of the MRI center.

The Hospital's liquidity decreased during the year ended December 31, 2005, due primarily to investments in certificates of deposits for original terms of longer than three months, which causes investments to be classified as short-term investments instead of cash and cash equivalents under the Hospital's policies.

Cash provided by financing activities decreased in 2006 and 2005 in comparison to 2005 and 2004, respectively, primarily due to a decline in donations received by the Foundation.

Cash used in capital and related financing activities was approximately $3.3 million in 2006 in comparison to $39,000 in 2005. This increase in cash used was caused by increased capital purchases in 2006 related to the MRI Center and $1.9 million in debt issued in 2005 versus no debt issued in 2006. Cash used on capital purchases net of related financing activities was approximately $2.1 million in 2004 due to a $1.9 million issuance of long-term debt in 2005.

Capital Asset and Debt Administration

Capital Assets

At December 31, 2006, the Hospital had approximately $20 million invested in capital assets, net of accumulated depreciation of approximately $41 million. Depreciation and amortization totaled $2.6 million for the current year compared to $2.8 million last year.

At December 31, 2005, the Hospital had approximately $20 million invested in capital assets, net of accumulated depreciation of $38 million. Depreciation and amortization totaled $2.8 million for 2005 compared to $2.9 million in 2004.

Details of the cost of these assets for the past three years are shown below.

	2006	2005	2004
Land and improvements	$ 2,444,188	$ 2,444,188	$ 2,386,026
Buildings and improvements	30,573,343	28,384,891	28,158,386
Furniture, fixtures and equipment	27,669,084	26,562,090	26,290,769
Construction in process	91,455	708,438	32,556
Total	$ 60,778,070	$ 58,099,607	$ 56,867,737

Debt

At December 31, 2006, the Hospital had $4.8 million of long-term debt outstanding as compared to $5.1 million the previous year. The decrease was due to the Hospital beginning to pay on the new loan taken out in 2005 related to the new MRI center.

At December 31, 2005, the Hospital had $5.1 million of long-term debt outstanding as compared to $3.5 million the previous year. The increase was due to tax-exempt funding of the Hospital addition to house the Hospital's MRI and nuclear medicine equipment.

More detailed information about the Hospital's long-term liabilities is presented in the footnotes to the financial statements.

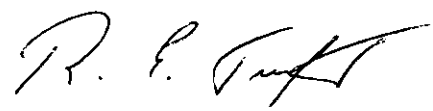
Other Economic Factors That Will Affect the Future

The economic position of the Hospital is closely tied to that of the local economy. Because of limited economic growth and increased demand for resources where reimbursement is limited by federal and state mandates, the current budget projects only an inflationary increase in funding to the Hospital in the next year. In addition, the Board of Trustees approved an increase of 5-6% in the charge structure for the 2006 fiscal year.

The Hospital has developed operating and capital budgets that management believes will allow it to maintain the Hospital's present level of services in light of expected changes in reimbursement and expense trends.

Contacting the Hospital's Financial Management

This financial report is intended to provide our member townships and bondholders with a general overview of the Hospital's finances, and to show the Hospital's accountability for the money it receives from the member townships. If you have questions about this report or need additional information, please contact the Chief Financial Officer.



Richard E. Trufant,
Chief Financial Officer

Community Health Center of Branch County
A Component Unit of Branch County, Michigan
Balance Sheets
December 31, 2006 and 2005

	2006	2005
Assets		
Current Assets		
Cash and cash equivalents	$ 4,512,532	$ 6,058,491
Short-term investments	2,874,893	2,940,893
Restricted cash and investments, current	4,867,988	5,038,278
Patient accounts receivable, net of allowances of: 2006 - $1,508,000, 2005 - $1,357,000	5,990,792	6,474,353
Estimated amounts due from third-party payers	1,513,573	271,816
Inventories	1,332,609	1,570,913
Prepaid expenses and other	2,021,950	1,133,167
Total current assets	23,114,337	23,487,911
Noncurrent Cash and Investments		
Restricted for capital acquisitions and specific operating activities		
By the Board	6,009,664	4,570,608
By donors	1,533,687	1,697,910
Less amounts required to meet current obligations	(4,867,988)	(5,038,278)
	2,675,363	1,230,240
Investments in equity investees	316,331	323,273
	2,991,694	1,553,513
Capital Assets, net	19,969,051	19,808,951
Other Assets	556,435	860,521
	$ 46,631,517	$ 45,710,896
Liabilities and Net Assets		
Current Liabilities		
Current maturities of long-term debt	$ 403,728	$ 382,251
Accounts payable	1,696,339	1,779,088
Accrued expenses	2,870,937	2,682,655
Estimated self-insurance costs	486,686	435,768
Total current liabilities	5,457,690	5,279,762
Long-Term Debt	4,350,604	4,755,275
Other Long-Term Liabilities	350,000	350,000
Total liabilities	10,158,294	10,385,037
Net Assets		
Invested in capital assets, net of related debt	15,214,719	14,671,425
Restricted-expendable for specific operating purposes	1,533,687	1,697,910
Unrestricted	19,724,817	18,956,524
Total net assets	36,473,223	35,325,859
	$ 46,631,517	$ 45,710,896

Community Health Center of Branch County
A Component Unit of Branch County, Michigan
Statements of Revenue, Expenses and Changes in Net Assets
Years Ended December 31, 2006 and 2005

	2006	2005
Operating Revenue		
Net patient service revenue, net of provision for uncollectible accounts; 2006 - $3,934,942, 2005 - $3,420,333	$ 58,370,311	$ 56,002,365
Other	391,875	391,132
Total operating revenue	58,762,186	56,393,497
Operating Expenses		
Salaries and wages	25,139,709	23,455,829
Employee benefits	6,148,792	6,649,377
Purchased services and professional fees	7,931,309	7,703,054
Supplies	12,682,158	11,707,991
Other expenses	3,713,216	3,309,974
Depreciation and amortization	2,549,895	2,788,577
Total operating expenses	58,165,079	55,614,802
Operating Income	597,107	778,695
Nonoperating Revenue (Expenses)		
Investment income	678,532	298,783
Interest expense	(196,750)	(151,415)
Gain (loss) on investment in equity investee	(6,941)	144,096
Contributions, net of program expenses	140,269	167,098
Donation expense	(64,853)	(24,363)
Total nonoperating revenue	550,257	434,199
Increase in Net Assets	1,147,364	1,212,894
Net Assets, Beginning of Year	35,325,859	34,112,965
Net Assets, End of Year	$ 36,473,223	$ 35,325,859

Community Health Center of Branch County
A Component Unit of Branch County, Michigan
Statements of Cash Flows
Years Ended December 31, 2006 and 2005

	2006	2005
Operating Activities		
Receipts from and on behalf of patients	$ 57,612,115	$ 56,249,341
Payments to suppliers and contractors	(30,462,376)	(30,075,451)
Payments to employees	(25,342,750)	(22,756,703)
Other receipts, net	391,875	391,132
Net cash provided by operating activities	2,198,864	3,808,319
Noncapital Financing Activities		
Noncapital gifts and grants, net of donation expense	75,416	142,735
Other	32,439	80,847
Net cash provided by noncapital financing activities	107,855	223,582
Capital and Related Financing Activities		
Proceeds from issuance of long-term debt	—	1,900,000
Principal paid on long-term debt	(383,194)	(252,474)
Interest paid on long-term debt	(196,750)	(151,415)
Purchase of capital assets	(2,718,737)	(1,538,820)
Net cash used in capital and related financing activities	(3,298,681)	(42,709)
Investing Activities		
Interest and dividends on investments	647,894	365,713
Purchase of investments	(10,465,935)	(14,282,363)
Proceeds from disposition of investments	10,172,048	7,142,687
Net cash provided by (used in) investing activities	354,007	(6,773,963)
Decrease in Cash and Cash Equivalents	(637,955)	(2,784,771)
Cash and Cash Equivalents, Beginning of Year	6,357,251	9,142,022
Cash and Cash Equivalents, End of Year	$ 5,719,296	$ 6,357,251
Reconciliation of Cash and Cash Equivalents to the Balance Sheet		
Cash and cash equivalents in unrestricted current assets	$ 4,512,532	$ 6,058,491
Cash and cash equivalents in restricted current assets	1,206,764	298,760
Total cash and cash equivalents	$ 5,719,296	$ 6,357,251
Reconciliation of Net Operating Revenue (Expenses) to Net Cash Provided by Operating Activities		
Operating income	$ 597,107	$ 778,695
Depreciation and amortization	2,549,895	2,788,577
Accrued self-insurance costs	50,918	50,550
Changes in operating assets and liabilities		
Patient accounts receivable, net	483,561	241,425
Estimated amounts due from third-party payers	(1,241,757)	5,551
Accounts payable and accrued expenses	105,533	737,607
Other current and long-term assets	(346,393)	(794,086)
Net cash provided by operating activities	$ 2,198,864	$ 3,808,319

Community Health Center of Branch County
A Component Unit of Branch County, Michigan
Notes to Financial Statements
December 31, 2006 and 2005

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Reporting Entity

Community Health Center of Branch County (Hospital) is a short-term, acute care hospital located in Coldwater, Michigan. The Hospital is a component unit of Branch County, Michigan (County) and the Board of County Commissioners appoints members to the Board of Trustees of the Hospital. The Hospital is organized under Public Act 230 of the Public Acts of 1987 as a county hospital corporation. The Hospital primarily earns revenue by providing inpatient, outpatient and emergency care services to patients in the Branch County area. It also operates a home health agency in the same geographic area.

Community Health Center Foundation, Inc. (Foundation) is a component unit of Community Health Center of Branch County, and its financial statements have been included with those of the Hospital, using the blended method. The Foundation was established to raise funds exclusively for a comprehensive program of fund development that supports the mission and vision of Community Health Center of Branch County. The Foundation maintains a separate Board of Directors. The Hospital appoints and approves the Foundation Board.

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenue, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally federal and state grants and county appropriations) are recognized when all applicable eligibility requirements are met. Operating revenue and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific (such as county appropriations), property taxes, investment income and interest on capital assets-related debt are included in nonoperating revenue and expenses. The Hospital first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

The Hospital prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) including those that were issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2006 and 2005, cash equivalents consisted primarily of money market accounts with brokers and certificates of deposit.

Risk Management

The Hospital is exposed to various risks of loss from torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than employee health claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

The Hospital is self-insured for a portion of its exposure to risk of loss from employee health claims. Annual estimated provisions are accrued for the self-insured portion of employee health claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

Investments and Investment Income

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at time of acquisition and in nonnegotiable certificates of deposit are carried at amortized cost. The investments in equity investees are reported on the equity method of accounting. All other investments are carried at fair value. Fair value is determined using quoted market prices.

Investment income includes dividend and interest income, realized gains and losses on investments carried at other than fair value and the net change for the year in the fair value of investments carried at fair value.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Inventories

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method or market.

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. The Hospital uses AHA guidelines for estimated useful lives.

The Hospital capitalizes interest costs as a component of construction in progress, based on the interest costs of borrowing specifically for the project, net of interest earned on investments acquired with the proceeds of the borrowing. Total interest capitalized and incurred was:

	2006	2005
Total interest expense incurred on borrowings for MRI building project	$ 51,046	$ 11,281
Interest income from investment of proceeds of borrowings for MRI building project	(19,356)	(9,368)
Net interest cost capitalized	$ 31,690	$ 1,913

	2006	2005
Interest capitalized	$ 51,046	$ 11,281
Interest charged to expense	196,750	151,415
Total interest incurred	$ 247,796	$ 162,696

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method.

Compensated Absences

Hospital policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Expense and the related liability for sick leave benefits are recognized when earned to the extent the employee is expected to realize the benefit. Compensated absence liabilities are computed using the regular pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

Net Assets

Net assets of the Hospital are classified in three components. Net assets invested in capital assets, net of related debt, consist of capital assets net of accumulated depreciation and reduced by the

outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital assets that must be used for a particular purpose as specified by creditors, grantors or donors external to the Hospital. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets, net of related debt or restricted expendable.

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medicaid programs.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue.

Income Taxes

As an essential government function of the County, the Hospital is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. The Foundation is exempt from federal income tax under Section 501(c)3 of the Internal Revenue Code. However, the Hospital and Foundation are subject to federal income tax on any unrelated business taxable income.

Foundation

The Foundation is a legally separate, tax-exempt component unit of the Hospital. The Foundation's primary function is to raise and hold funds to support the Hospital and its programs.

Although the Hospital does not control the timing or amount of receipts from the Foundation, the majority of the Foundation's resources and related income are restricted by donors for the benefit of the Hospital. The Foundation is considered a component unit of the Hospital and is presented as a blended component unit in the Hospital's financial statements.

Reclassifications

Certain reclassifications have been made to the 2006 financial statements from the presentation made in the 2005 financial statements. The reclassifications had no effect on the changes in net assets.

Note 2: Net Patient Service Revenue and Estimated Amounts Due From Third-Party Payers

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

Medicare. Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

Medicaid. Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicaid fiscal intermediary.

Blue Cross. Inpatient acute care services are reimbursed at prospectively determined rates per discharge. Outpatient services are reimbursed based on an established fee for service methodology. The Hospital is reimbursed for essentially all services at tentative rates with final settlement determined after analysis of activity by Blue Cross.

Approximately 79% and 83% of Hospital activity is from participation in the Medicare, Medicaid and Blue Cross programs for the years ended December 31, 2006 and 2005. Laws and regulations governing these programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Note 3: Deposits, Investments and Investment Income

Hospital deposits and investments information (exclusive of Foundation deposits and investments) are as follows:

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Hospital's deposit policy for custodial credit risk requires compliance with the provisions of state law.

State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the State of Michigan; bonds of any city, county, school district or special road district of the State of Michigan; or a surety bond having an aggregate value at least equal to the amount of the deposits.

At December 31, 2006 and 2005, approximately $2,971,000 and $7,738,000 of the Hospital's bank balances of approximately $6,827,000 and $10,522,000 were exposed to custodial credit risk as follows:

	2006	2005
Uninsured and uncollateralized	$ 2,971,000	$ 7,738,000
Uninsured and collateral held by pledging financial institutions trust department or agent in other than the Hospital's name	3,113,000	1,867,030
	$ 6,084,000	$ 9,605,030

Investments

The Hospital may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities and in bank repurchase agreements. It may also invest to a limited extent in corporate bonds.

At December 31, 2006 and 2005, the Hospital had the following investments and maturities:

	December 31, 2006				
		Maturities in Years			
Type	Fair Value	Less than 1	1-5	6-10	More than 10
U.S. Treasury obligations	$ 2,048,146	$ 1,219,019	$ 829,127	$ —	$ —
U.S. agencies obligations	5,231,519	3,676,500	1,555,019	—	—
	$ 7,279,665	$ 4,895,519	$ 2,384,146	$ 0	$ 0

	December 31, 2005				
		Maturities in Years			
Type	Fair Value	Less than 1	1-5	6-10	More than 10
U.S. Treasury obligations	$ 1,790,973	$ 321,002	$ 1,469,971	$ —	$ —
U.S. agencies obligations	2,064,306	1,768,056	296,250	—	—
	$ 3,855,279	$ 2,089,058	$ 1,766,221	$ 0	$ 0

Interest Rate Risk - As a means of limiting its exposure to fair value losses arising from rising interest rates, the Hospital's investment policy limits its investment portfolio to maturities of five years or less.

Credit Risk - Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. At December 31, 2006 and 2005, the Hospital's investments in U.S. agencies obligations not directly guaranteed by the U.S. government were rated AAA by Standard & Poor's. Investments in money market funds were not rated.

Custodial Credit Risk - For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All of the underlying securities for the Hospital's investments in sweep accounts at December 31, 2006 and 2005, are held by the counterparties in the Hospital's name. The Hospital's investment policy does not address how securities underlying sweep accounts are to be held.

Concentration of Credit Risk - The Hospital limits the amount that may be invested in any one issuer to no more than 50% except for U.S. Treasury securities and at December 31, 2006 and 2005, the Hospital was in compliance with this policy.

Foundation deposits and investments information (exclusive of Hospital deposits and investments) are as follows:

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. At December 31, 2006 and 2005, the Foundation's bank balances of approximately $186,000 and $153,000, respectively, were exposed to custodial credit risk as follows:

	2006	2005
Uninsured and collateral held by pledging financial institution's trust department or agent in other than the Foundation's name	$ 109,000	$ 54,000

Investments

The Foundation's investment policy allows investment in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities. It may also invest in equity securities.

At December 31, 2006 and 2005, the Foundation had the following investments and maturities:

	December 31, 2006				
		Maturities in Years			
Type	Fair Value	Less Than 1	1-5	6-10	More Than 10
U.S. Treasury obligations	$ 193,989	$ 24,805	$ 120,216	$ 48,968	$ —
Corporate bonds	157,107	35,076	122,031	—	—
Money market mutual funds	46,455	46,455	—	—	—
	397,551	$ 106,336	$ 242,247	$ 48,968	$ 0
Corporate stocks	664,975				
	$1,062,526				

	December 31, 2005				
		Maturities in Years			
Type	Fair Value	Less Than 1	1-5	6-10	More Than 10
U.S. Treasury obligations	$ 195,083	$ —	$ 104,486	$ 90,597	$ —
Corporate bonds	155,047	—	88,008	67,039	—
Money market mutual funds	40,915	40,915	—	—	—
	391,045	$ 40,915	$ 192,494	$ 157,636	$ 0
Corporate stocks	692,183				
	$1,083,228				

Credit Risk - Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. At December 31, 2006 and 2005, the Foundation's investments in corporate bonds were rated BB or better by Standard & Poor's. At those dates, the Foundation's investments in U.S. agencies obligations not directly guaranteed by the U.S.

government were rated AAA by Standard & Poor's. Investments in money market funds and mutual funds were not rated.

Custodial Credit Risk - For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Foundation will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All of the underlying securities for the Foundation's investments are held by the counterparties in other than the Foundation's name, not the Hospital's name. The Foundation's investment policy does not address how securities are to be held.

Concentration of Credit Risk - The Foundation places no limit on the amount that may be invested in any one issuer, but does limit the maximum of any one holding, excluding direct obligations of the U.S. government and U.S. agencies, to 5% or less of the total fund assets of any one issuer at cost or market.

Summary of Carrying Values

The carrying values of Hospital and Foundation deposits and investments shown above are included in the balance sheets as follows:

	2006	2005
Carrying value		
Deposits	$ 6,588,585	$ 10,329,395
Investments	8,342,191	4,938,507
	$ 14,930,776	$ 15,267,902
Included in the following balance sheets captions		
Cash and cash equivalents	$ 4,512,532	$ 6,058,491
Short-term investments	2,874,893	2,940,893
Restricted cash and investments, current	4,867,988	5,038,278
Noncurrent cash and investments	2,675,363	1,230,240
	$ 14,930,776	$ 15,267,902

Investment Income

Investment income of the Hospital and the Foundation for the years ended December 31, 2006 and 2005, consisted of:

	2006	2005
Interest and dividend income	$ 647,894	$ 365,713
Net increase (decrease) in fair value of investments	30,638	(66,930)
	$ 678,532	$ 298,783

Note 4: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Net patient accounts receivable at December 31, 2006 and 2005, consisted of:

	2006	2005
Medicare	$ 2,262,270	$ 2,134,463
Medicaid	389,328	467,984
Blue Cross	522,800	932,041
Other third-party payers and other	1,717,139	2,067,592
Patients	2,607,255	2,229,273
	7,498,792	7,831,353
Less allowance for uncollectible accounts	(1,508,000)	(1,357,000)
	$ 5,990,792	$ 6,474,353

Note 5: Capital Assets

Capital assets activity for the years ended December 31, 2006 and 2005, was:

	2006				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 1,369,253	$ —	$ —	$ —	$ 1,369,253
Land improvements	1,074,935	—	—	—	1,074,935
Buildings and leasehold improvements	28,384,891	48,348	(30,000)	2,170,104	30,573,343
Equipment	26,562,090	1,074,873	(10,274)	42,395	27,669,084
Construction in progress	708,438	1,595,516	—	(2,212,499)	91,455
	58,099,607	2,718,737	(40,274)	—	60,778,070
Less accumulated depreciation	(38,290,656)	(2,549,895)	31,532	—	(40,809,019)
Capital assets, net	$ 19,808,951	$ 168,842	$ (8,742)	$ 0	$ 19,969,051

	2005				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 1,369,253	$ —	$ —	$ —	$ 1,369,253
Land improvements	1,016,773	58,162	—	—	1,074,935
Buildings and leasehold improvements	28,158,386	229,005	(2,500)	—	28,384,891
Equipment	26,290,769	575,771	(304,450)	—	26,562,090
Construction in progress	32,556	675,882	—	—	708,438
	56,867,737	1,538,820	(306,950)	—	58,099,607
Less accumulated depreciation	(35,805,348)	(2,788,577)	(303,269)	—	(38,290,656)
Capital Assets, Net	$ 21,062,389	$ (1,249,757)	$ (3,681)	$ 0	$ 19,808,951

Note 6: Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses included in current liabilities at December 31, 2006 and 2005, consisted of:

	2006	2005
Payable to suppliers and contractors	$ 1,696,339	$ 1,779,088
Payable to employees (including payroll taxes and benefits)	2,789,382	2,586,341
Other	81,555	96,314
	$ 4,567,276	$ 4,461,743

Note 7: Medical Malpractice Claims

The Hospital purchases medical malpractice insurance under a claims-made policy on a fixed premium basis under which the Hospital is responsible for the first $100,000 per occurrence and $200,000 in aggregate of medical malpractice risk. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claims experience, an accrual has been made as summarized below:

	2006	2005
Balance, beginning of year	$ 183,014	$ 153,615
Current year claims incurred and changes in estimates for claims incurred in prior years	155,548	65,996
Claims and expenses paid	(122,573)	(36,597)
Balance, end of year	$ 215,989	$ 183,014

It is reasonably possible that this estimate could change materially in the near term.

Note 8: Employee Health Claims

Substantially all of the Hospital's employees and their dependents are eligible to participate in the Hospital's employee health insurance plan. The Hospital is self-insured for health claims of participating employees and dependents up to an annual individual amount of $125,000. Commercial stop-loss insurance coverage is purchased for claims in excess of the individual annual amount. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is reasonably possible that the Hospital's estimate will change by a material amount in the near term.

Activity in the Hospital's accrued employee health claims liability during 2006 and 2005 is summarized as follows:

	2006	2005
Balance, beginning of year	$ 252,754	$ 231,603
Current year claims incurred and changes in estimates for claims incurred in prior years	4,924,734	5,895,145
Claims and expenses paid	(4,906,791)	(5,873,994)
Balance, end of year	$ 270,697	$ 252,754

Note 9: Long-Term Debt

Long-term debt amounts consist of two bond issues:

The Building Authority Bonds, Series 2001 (2001 Bonds) issued through the Branch County Building Authority in the original amount of $4,000,000 dated March 1, 2001, bear interest at 4.375% to 4.500%. The 2001 Bonds are payable in annual installments through September 1, 2016, and are collateralized by a lease agreement on the building and surrounding land with the Authority and the County. In turn, the County subleases the building and land to the Hospital under the same terms. The Hospital makes payment directly to the Authority. The indenture

agreement requires the Hospital to comply with certain restrictive covenants including minimum insurance coverage.

The 2005 Term Loan Bonds (2005 Bonds) issued with an original amount of $1,900,000 dated October 12, 2005, bears interest at LIBOR plus 2.25% (currently 5.34%). The 2005 Bonds are payable in monthly installments through November 1, 2015. The Bonds are secured by the net revenue and accounts receivable of the Hospital and the assets restricted under the bond indenture agreement. The indenture agreement requires the Hospital to comply with certain restrictive covenants including minimum insurance coverage, maintaining a historical debt-service coverage ratio of at least 1.25 to 1.00, maintaining a ratio of funded debt to funded debt plus net assets of no more than .50 and maintaining minimum days of cash on hand of 75 days.

The debt service requirements for both bond issues as of December 31, 2006, are as follows (assuming the December 31, 2006, LIBOR rate of 5.34% for the entire period):

Year Ending December 31	Total to be Paid	Principal	Interest
2007	$ 626,649	$ 403,728	$ 222,921
2008	624,123	420,608	203,515
2009	626,968	443,700	183,268
2010	628,434	466,492	161,942
2011	629,018	489,550	139,468
2012 – 2016	2,854,798	2,530,254	324,544
	$ 5,989,990	$ 4,754,332	$ 1,235,658

Note 10: Restricted and Designated Net Assets

At December 31, 2006 and 2005, restricted expendable net assets of $1,533,687 and $1,697,910, respectively, were available for specific operating activities as designated by the donors.

Note 11: Operating Leases

Noncancellable operating leases for office space and equipment expire in various years through 2010. Total operating lease expense for 2006 and 2005 was $723,000 and $292,470, respectively.

Future minimum lease payments at December 31, 2006, were:

2007	$ 911,295
2008	874,595
2009	872,748
2010	596,378
2011	194,037
Future minimum lease payments	$ 3,449,053

Note 12: Pension Plan

Plan Description

The Hospital contributes to the Branch County Pension Plan, a cost-sharing multiple-employer defined benefit pension plan administered by the County of Branch, Michigan. The ability to establish and amend benefit provisions is assigned to the Branch County Board of Commissioners, the members of which are elected. Pension expense is recorded for the amount the Hospital is contractually required to contribute for the year. The plan provides retirement and disability benefits, including annual cost-of-living adjustments and death benefits to plan members and their beneficiaries. The plan does not issue a separate financial report.

Funding Policy

The authority to establish and amend requirements of plan members and the Hospital is vested in the Branch County Board of Commissioners. Plan members are required to contribute 3% of the first $4,800 of gross wages, plus 5% of the remaining amount. The Hospital is required to contribute at an actuarially determined rate; the rate was 6.08% and 6.45% of annual covered payroll for 2006 and 2005, respectively. The Hospital's contributions to the plan for 2006, 2005 and 2004, were $451,874, $348,925 and $317,131, respectively, which equaled the required contributions for each year.

Note 13: Contingencies

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's self-insurance program (discussed elsewhere in these notes) or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Approximately 30% of the Hospital workforce is covered by collective bargaining agreements. The Hospital could encounter difficulties in obtaining qualified employees in the future if these agreements are not renewed.

Note 14: Retiree Medical Plan

The Hospital offers a group health insurance plan to former employees with 20 years or more of service who are at least 60 years of age, not eligible for Medicare benefits or other medical benefits, and did not terminate employment with the Hospital before January 1, 1998. Five former employees were participating in this plan on December 31, 2006. The Hospital pays the cost of this plan for participants. The Hospital had $14,589 and $20,358 in expenses related to this plan in

2006 and 2005, respectively, for costs actually incurred in the current year as recorded under the Hospital's current accounting methodology.

The Governmental Accounting Standards Board (GASB) recently issued its Statement No. 45 (GASB No. 45), *Accounting and Financial Reporting by Employers for Post-Employment Benefits Other Than Pension.* The Statement provides accounting and disclosure requirements for postemployment benefit plans in which the Hospital participates. GASB No. 45 generally requires recognition of expenses for postretirement benefits as services are performed, regardless of the timing of the related benefit payment.

The Hospital expects to first apply GASB No. 45 during the year ending December 31, 2007, using a prospective recognition method. Under this method, the Hospital's net unfunded obligation under the plan at the effective date will be amortized over a period not to exceed 30 years. The impact of applying this Statement has not been determined.

Supplementary Information

Community Health Center of Branch County
A Component Unit of Branch County, Michigan
Balance Sheet Information
December 31, 2006

	Community Health Center of Branch County	Community Health Center Foundation	Total
Assets			
Current Assets			
Cash and cash equivalents	$ 4,512,532	$ —	$ 4,512,532
Short-term investments	2,874,893	—	2,874,893
Restricted cash and investments, current	3,918,102	949,886	4,867,988
Patient accounts receivable, net of allowances of $1,508,110	5,990,792	—	5,990,792
Estimated amounts due from third-party payers	1,513,573	—	1,513,573
Inventories	1,332,609	—	1,332,609
Prepaid expenses and other	2,021,950	—	2,021,950
Total current assets	22,164,451	949,886	23,114,337
Noncurrent Cash and Investments			
Restricted for capital acquisitions and speeific operating activities			
By the Board	6,009,664	—	6,009,664
By donors	292,585	1,241,102	1,533,687
Less amounts required to meet current obligations	(3,918,102)	(949,886)	(4,867,988)
	2,384,147	291,216	2,675,363
Investments in eqnity investees	316,331	—	316,331
	2,700,478	291,216	2,991,694
Capital Assets, net	18,927,801	1,041,250	19,969,051
Other Assets	556,435	—	556,435
	$ 44,349,165	$ 2,282,352	$ 46,631,517
Liabilities and Net Assets			
Current Liabilities			
Current maturities of long-term debt	$ 403,728	$ —	$ 403,728
Accounts payable	1,696,339	—	1,696,339
Accrued expenses	2,870,937	—	2,870,937
Estimated self-insurance costs	486,686	—	486,686
Total current liabilities	5,457,690	—	5,457,690
Long-Term Debt	4,350,604	—	4,350,604
Other Long-Term Liabilities	350,000	—	350,000
Total liabilities	10,158,294	—	10,158,294
Net Assets			
Invested in capital assets, net of related debt	14,173,469	1,041,250	15,214,719
Restricted-expendable for specific operating purposes	292,585	1,241,102	1,533,687
Unrestricted	19,724,817	—	19,724,817
Total net assets	34,190,871	2,282,352	36,473,223
	$ 44,349,165	$ 2,282,352	$ 46,631,517

Community Health Center of Branch County
A Component Unit of Branch County, Michigan
Statement of Revenue, Expenses and Changes in Net Assets Information
Year Ended December 31, 2006

	Community Health Center of Branch County	Community Health Center Foundation	Eliminations	Total
Operating Revenue				
Net patient service revenue, net of provision for uncollectible accounts of $3,934,942	$ 58,370,311	$ —	$ —	$ 58,370,311
Other	391,875	—	—	391,875
Total operating revenue	58,762,186	—	—	58,762,186
Operating Expenses				
Salaries and wages	25,139,709	—	—	25,139,709
Employee benefits	6,148,792	—	—	6,148,792
Purchased services and professional fees	7,931,309	—	—	7,931,309
Supplies	12,682,158	—	—	12,682,158
Other expenses	3,713,216	—	—	3,713,216
Depreciation and amortization	2,547,395	2,500	—	2,549,895
Total operating expenses	58,162,579	2,500	—	58,165,079
Operating Income	599,607	(2,500)	—	597,107
Nonoperating Revenue (Expenses)				
Investment income	552,086	126,446	—	678,532
Interest expense	(196,750)	—	—	(196,750)
Loss on investment in equity investee	(6,941)	—	—	(6,941)
Contributions, net of program expenses	197,000	138,898	(195,629)	140,269
Donation expense	—	(260,482)	195,629	(64,853)
Total nonoperating revenue	545,395	4,862	—	550,257
Increase in Net Assets	1,145,002	2,362	—	1,147,364
Net Assets, Beginning of Year	33,045,869	2,279,990	—	35,325,859
Net Assets, End of Year	$ 34,190,871	$ 2,282,352	$ 0	$ 36,473,223

Audit Committee, Board of Trustees and Management
Community Health Center of Branch County
Coldwater, Michigan

As part of our audit of the financial statements of the Community Health Center of Branch County as of and for the year ended December 31, 2006, we wish to communicate the following to you.

Audit Scope and Results

Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America

An audit performed in accordance with auditing standards generally accepted in the United States of America (GAAS) is designed to obtain reasonable, rather than absolute, assurance about the financial statements. In performing GAAS procedures, we establish scopes of audit tests in relation to the financial statements taken as a whole. Our engagement does not include a detailed audit of every transaction. Our engagement letter more specifically describes our responsibilities.

Significant Accounting Policies

The Company's significant accounting policies are described in Footnote 1 of the audited financial statements. Management has the responsibility for selection and use of appropriate accounting principles, and we have the responsibility to advise it about appropriate accounting principles and their application. Our engagement letter more specifically describes our responsibilities. During this year, the accounting principles selected and used were consistent with those used in the preceding year.

Management Judgments and Accounting Estimates

Accounting estimates are an integral part of financial statement preparation by management, based on its judgments. The following areas involve significant areas of such estimates for which we are prepared to discuss management's estimation process and our procedures for testing the reasonableness of those estimates:

- Allowances for uncollectible accounts receivable, based on analysis of payment history, current status, financial conditions, and anticipated economic conditions.
- Allowance for contractual adjustments on third-party payor contracts based on historical contractual adjustment activity and current status of accounts receivable balances.
- Liability for third-party settlements and audit adjustments based on information received and historical activity.

- Liability for reported and incurred but not yet reported claims under the malpractice insurance and group health insurance programs based on historical claim activity and information received from third-party administrators of these programs.

Audit Adjustments

During the course of any audit, an auditor may propose adjustments to financial statement amounts. Management evaluates our proposals and records those adjustments which, in its judgment, are required to prevent the financial statements from being materially misstated. Some adjustments proposed were not recorded because their aggregate effect is not currently material; however, they involve areas in which adjustments in the future could be material, individually or in the aggregate.

Areas in which adjustments were proposed, including those which management recorded, include:

- Increase of the estimated liability for reported and incurred but not yet reported claims under the malpractice insurance and group health insurance programs.

- Increase to the estimated liability for the 2002, 2003 and 2004 Medicare cost report settlement based on new information obtained by management from the fiscal intermediary in the current year.

Attached is a summary of unposted identified adjustments we aggregated during the current engagement and pertaining to the latest period presented that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements as a whole.

Disagreements with Management

Disagreements with management occasionally arise over the application of accounting principles, basis for estimates made by management or the wording of the auditor's report. We did not encounter any disagreements with management during our audit.

Consultation with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain matters. If a consultation involves application of an accounting principle to the Hospital's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Difficulties Encountered in Performing the Audit

We want to thank the personnel in the accounting department for their responsiveness to our inquiries and requests. We experienced no unusual difficulties in performing our audit procedures.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements of the Community Health Center of Branch County as of and for the year ended December 31, 2006, in accordance with auditing standards generally accepted in the United States of America, we considered the Hospital's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control. As such, our consideration of internal controls would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements of the Hospital's financial statements on a timely basis. A control deficiency in design exists when a control necessary to meet a control objective is missing or an existing control is not properly designed so that, even if the control operates as designed, a control objective is not always met. A control deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Hospital's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Hospital's financial statements that is more than inconsequential will not be prevented or detected.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the Hospital's financial statements will not be prevented or detected by the Hospital's internal controls.

We observed the following matters that we consider to be control deficiencies, significant deficiencies or material weaknesses. Previously, we made observations as a result of our 2005 audit engagement in a letter dated March 2, 2006.

Material Weaknesses

No matters are reportable.

Significant Deficiencies

2002, 2003 and 2004 Medicare Third-Party Settlement Liabilities

The estimation methodology utilized by the Hospital to record the 2002, 2003 and 2004 Medicare third-party settlement liabilities have understated the actual liabilities based on new information developed as a part of the audit of these cost reports by the Medicare fiscal intermediary.

We recommend that management consider the issues which have caused this understatement, which are primarily related to disproportionate share and graduate medical education reimbursement, and adjust the estimation methodology to better reflect the actual settlement

outcomes. We also recommend that management reconsider prior estimates whenever pertinent new information is available.

Medical Malpractice Accrual

Based on an analysis of medical malpractice claims, the full amount of the estimated liability on one open case was not recorded as a liability at December 31, 2006. As a result, an audit adjustment was proposed to correct the recorded liability at December 31, 2006.

We recommend that management reevaluate the methodology utilized for this estimate in future periods.

Group Health Insurance Accrual

Based on an analysis of group health insurance incurred but not reported (IBNR) claims and analysis of the estimated amount due the third-party administrator of this plan, the amount of the IBNR claims were estimated in amount higher than the methodology utilized by management. As a result, an audit adjustment was proposed to correct the recorded liability at December 31, 2006.

We recommend that management reevaluate the methodology utilized for this estimate in future periods.

Physician Personal Days Off (PDO)

The Hospital accrues physician PDO at the beginning of their contract year for the entire year and then records a contra-liability account to offset the PDO and amortizes the expense over the contract year of the physician. This methodology does not record a liability that corresponds to what is actually owed to the physician at any given time. This unrecorded liability was $56,500 at December 31, 2006. An audit adjustment was proposed but not recorded to correct the recorded liability.

We recommend that management reevaluate this recording methodology for future periods.

Control Deficiencies

No matters are reportable.

Other Matters

Although not considered material weaknesses, significant deficiencies or other control deficiencies in internal control over financial reporting, we observed the following matters and offer these comments and suggestions with respect to matters which came to our attention during the course of the audit of the financial statements. Our audit procedures are designed primarily to enable us to form an opinion on the financial statements and, therefore, may not bring to light all weaknesses in policies and procedures that may exist. However, these matters are offered as constructive suggestions for the consideration of management as part of the ongoing process of modifying and improving accounting controls and the financial and administrative practices and procedures. We can discuss these matters further at your convenience and may provide implementation assistance for changes or improvements if you require.

Prior Year Comments

Current Governance Environment

The Sarbanes-Oxley Act (ACT) was signed into law in July 2002, and primarily applies to public companies. Its purpose is to build and restore confidence in public financial reporting. The Act establishes required communication and responsibilities for audit committees, management and independent auditors. Although the Hospital is not currently subject to the Act, it may be appropriate to give consideration to its requirements, especially given recent developments in which bond rating agencies and several state governments have begun requiring compliance with certain or similar provisions of the Act.

We continue to recommend attention to provisions within the Act associated with the evaluation of internal controls ("Section 404 requirements"). While the full requirements of this section of the Act include attestation provisions that are probably prohibitively costly to implement for a smaller organization, the general provisions of the section prescribe a comprehensive assessment of the internal control and financial reporting structure which is designed to detect and repair internal control weaknesses within adopting organizations.

Contractual Allowance and Estimated Third-Party Settlement Recording Process

As a part of our audit procedures, we analyzed the recording methodology utilized by the Hospital to estimate contractual allowances and third-party settlements. The effectiveness of this methodology is key to the accuracy of recorded financial information for any acute care hospital, but is especially important to the Hospital given the high level of third-party payors (Medicare inpatient, traditional Medicaid inpatient, all Blue Cross) paying the Hospital on a prospective interim basis with associated retroactive final settlements in future years.

We noted in the prior year that the methodology employed by the Hospital for these estimates is highly complex, utilizing a mixture of techniques that may create confusion in the calculation and analysis of the estimates. In addition, the methodology does not separately analyze add-on payments settled in the cost report such as disproportionate share payments, does not incorporate potential contractual allowances associated with programs other than Medicare, Medicaid and Blue Cross, and does not incorporate the effect of credits within open receivable balances. Finally, the methodology does not accrue the future receipt of prospective interim payments as is standard industry accounting practice.

Management has indicated that these recommendations will be considered when changes are made to the estimation methodology in association with the implementation of a new patient financial information system in 2007. We encourage management in this effort.

Purchasing Process

While testing the Hospital's purchasing process, we noted that competitive bids are not obtained for certain supply purchases, and that the lowest supplier cost identified for acceptable quality appears to not always be purchased. The ability of the Hospital to obtain competitive bids for supply purchases is limited to some extent by participation in purchasing arrangements undertaken to obtain more favorable pricing. We continue to recommend pricing/quality studies be performed and documented by the Hospital, and that competitive bids be sought when possible to insure the best possible pricing is obtained for Hospital purchases.

Billing System for Anesthesiology Professional Fees

The Hospital currently utilizes an outside third party to process anesthesiology professional charges. Due to various issues regarding when the outside third-party receives necessary information from the Hospital to bill these services and the billing system and process utilized, the Hospital was required to accrue estimated revenue at December 31, 2006, for over one month of Anesthesiology revenue. We continue to recommend that the Hospital investigate the effectiveness of this system given the apparent delay in processing claims.

Retiree Medical Plan

The Hospital currently offers a group health insurance plan to retirees meeting certain parameters and records associated costs on a "pay as you go" basis as allowed under current generally accepted accounting guidelines. GASB has recently promulgated Statement No. 45 which will require the Hospital to record the estimated costs of this plan on a prospective basis when the Statement becomes effective for the Hospital next year. We recommend that the Hospital analyze the potential effect of this required change in the coming year to better plan for the implementation of this change.

Deferred Compensation Agreement

The Hospital has entered into a deferred compensation arrangement with a key employee and has funded an investment to pay the required liability in the future. We continue to recommend that analysis of the liability associated with the deferred compensation agreement, tax reporting requirements associated with the liability and the fair value of the investments associated with the agreement be performed on a regular basis by Hospital management to better insure proper accounting treatment of these issues.

Current Year Comments

Physician Receivables

Due to the likelihood that physicians will complete the service requirements included in most physician loan agreements, we recommend that the Hospital consider recording a reserve to recognize this future forgiveness at the time these arrangements are signed.

Prepaid Expenses

During our review of prepaid assets, it was noted that the Hospital records the prepaid expenses in their entirety prior to being paid. The Hospital also records an offsetting liability related to these assets, so in theory the net balance is correct, but this complicates the recording and tracking of prepaid expenses by creating additional entries and accounts that are not necessary.

We recommend the Hospital look into the process of how they record prepaid expenses to simplify the process.

Review of Monthly Journal Entries

During our review of journal entries, it was noted that there is no documentation of journal entry review.

We recommend that the review of monthly journal entries now being performed by the CFO be documented by written approval on a copy of the journal entries maintained by the Hospital.

This communication is intended solely for the information and use of management, the Board of Trustees, the Audit Committee, others within the organization and the State of Michigan and is not intended to be and should not be used by anyone other than these specified parties.

BKD, LLP

March 27, 2007

Community Health Center of Branch County
ATTACHMENT

This analysis and the attached Schedule reflects the effects on the financial statements if the items identified were corrected.

QUANTITATIVE ANALYSIS

	Before Unposted Adjustments	Unposted Adjustements	Adjusted	% Change
Current Assets	23,114,337	(120,139)	22,994,198	-0.52%
Non-Current Assets	23,517,180	347,021	23,864,201	1.48%
Current Liabilities	(5,457,690)	(177,854)	(5,635,544)	3.26%
Non-Current Liabilities	(4,700,604)	(225,639)	(4,926,243)	4.80%
Current Ratio	4.235		4.080	-3.66%
Total Assets	46,631,517	226,882	46,858,399	0.49%
Invest in Capital Assets, net of Debt	(14,173,469)		(14,173,469)	
Restricted Net Assets	(2,574,937)		(2,574,937)	
Unrestricted Net Assets	(19,724,817)	176,611	(19,548,206)	-0.90%
Total Net Assets	(36,473,223)	176,611	(36,296,612)	-0.48%
Operating Revenues	(58,762,186)	21,457	(58,740,729)	-0.04%
Operating Expenses	58,165,079	31,228	58,196,307	0.05%
Nonoperating (Revenues) Expenses	(550,257)		(550,257)	
Change in Net Assets	(1,147,364)	52,685	(1,094,679)	-4.59%
Change in Net Assets - Three Year Average	(1,307,914)	52,685	(1,255,229)	-4.03%

Client: Community Health Center of Branch County

Period Ending: December 31, 2006

Description	Assets		Liabilities		Operating Revenues	Operating Expenses	Nonoperating (Revenues) Expenses	Net Assets (Beg. of year)	Invested in Capital Assets, Net	Restricted Net Assets	Unrestricted Net Assets	Net Effect on Following Year	
	Current	Non-Current	Current	Non-Current								Change in Net Assets	Net Assets
	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)
To reverse prior year PHP withholds entry passed adjustment					(19,705)			19,705					
To reverse prior year incentive accrual passed adjustment						(18,750)		18,750					
To reverse prior year accrued repayment of physician PDO passed adjustment						(85,471)		85,471					
Accrued repayment of physician PDO			(56,528)			56,528					56,528	(56,528)	56,528
To reclassify credit balances from AR to AP	121,326		(121,326)										
To include current year in emort of phy guarantee	(78,921)					78,921					78,921	(78,921)	78,921
To reclass CIP from other AR	(121,382)	121,382											
Current year PHP withhold accrual	(30,530)				30,530						30,530	(30,530)	30,530
adjust 2004 MD settlement erstimate	(10,632)				10,632						10,632	(10,632)	10,632
Deferred Comp and associated annuity value		225,639		(225,639)									
Total passed adjustments	(120,139)	347,021	(177,854)	(225,639)	21,457	31,228		123,926			176,611	(176,611)	176,611

Impact on Change in Net Assets	52,685
Impact on Net Assets	176,611